No. 11699

In the United States Circuit Court of Appeals for the Ninth Circuit

C. A. VAN DUSEN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

THERON LAMAR CAUDLE,
Assistant Attorney General.
GEORGE A. STINSON,
LEE A. JACKSON,
MARYHELEN WIGLE,
Special Assistants to the Attorney General.

FILED
DEC 24 1947
PAUL P. O'BRIEN, CLERK

INDEX

CITATIONS

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 11699

C. A. Van Dusen, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Tax Court (R. 102–106) is reported in 8 T. C. 388.

JURISDICTION

This petition for review (R. 108–110) involves federal income tax for the years 1938–1941 in the total amount of $6,953.20 (R. 107). Notice of deficiency was mailed the petitioner by the Commissioner of Internal Revenue on March 10, 1944 (R. 9); and within ninety days thereafter, June 5, 1944, petitioner filed a petition with the Tax Court for a redetermination under the provisions of Section 272 of the Internal Revenue Code (R. 4–18). The decision of the Tax Court was entered May 1, 1947. (R. 107.) The case is brought to this Court by a petition for review filed June 20, 1947 (R. 108–110), pursuant to the pro-

visions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether the Tax Court erred in determining that taxpayer received income, within the meaning of Section 22 (a) of the Internal Revenue Code, through his bargain purchases of shares in a corporation of which he was an employee, pursuant to option granted him by the corporation's president, whose personal holdings they were.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) [As amended by Sec. 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property;
>
> * * * * *
>
> (26 U. S. C. 1940 ed., Sec. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

> SEC. 19.22 (a)-1. WHAT INCLUDED GROSS INCOME.—Gross income includes in general com-

pensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.

*   *   *   *   *

If property is transferred by a corporation to a shareholder, or by an employer to an employee, for an amount substantially less than its fair market value, regardless of whether the transfer is in the guise of a sale or exchange, such shareholder or employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value to the extent that such difference is in the nature of (1) compensation for services rendered or to be rendered * * *

STATEMENT

The facts were found by the Tax Court in accordance with the parties' stipulation and from testimony of witnesses, and are as follows (R. 96–101):

C. A. Van Dusen, hereinafter called the taxpayer, and Wanda V. Van Dusen were husband and wife, and were residents of the State of California throughout each of the years 1938, 1939, 1940 and 1941. (R. 96.)[1]

[1] The taxpayer and his wife filed separate income tax returns for the calendar years 1938, 1939, 1940, and 1941. (R. 97.) The Commissioner assessed similar deficiencies against the wife, and

On December 10, 1934, the taxpayer entered the employ of Consolidated Aircraft Corporation as factory manager at a salary of $9,000 per annum, pursuant to an oral agreement entered into on December 7, 1934. (R. 96.)

The taxpayer received salary from Consolidated Aircraft Corporation as follows (R. 96–97):

	Salary
1938	[1] $15, 205. 04
1939	16, 020. 08
1940	22, 442. 50
1941	31, 255. 00

[1] $8,601.01 of his salary for 1938 was exempt from taxation because received for foreign service.

On December 7, 1934, R. H. Fleet, president of Consolidated Aircraft Corporation, gave to the taxpayer an oral option for the purchase of stock of Consolidated Aircraft Corporation, which option was reduced to writing on December 10, 1934, and was terminated by written agreement on December 31, 1941, the written option and termination being in the following words and figures (R. 97–98):

CONSOLIDATED AIRCRAFT CORPORATION

BUFFALO, NEW YORK

R. H. Fleet, President

DECEMBER 10, 1934.

MR. CHARLES A. VAN DUSEN, (Confidential).

DEAR VAN: In connection with your employment this day by our company, it gives me much pleasure to confirm my offer to sell you fifty (50) shares of my personal common stock

---

she was a petitioner below. It has now been stipulated that the wife's case shall be governed by the decision in this one.

in this corporation at the price of $5 net per share each and every month for the next ten years, (unless I die or cease to be an employee of Consolidated, in which event this is modified against me or my estate to five years from this date), this right to hold, however, only so long as you are retained in the company's employ.

You are under no obligation to purchase or to hold after purchase, any such stock under this offer; failing to purchase any month you forfeit nothing but the right to buy that month's quota of 50 shares.

So that you may get prompt delivery of any shares you purchase hereunder, I will leave sufficient of my shares, in street names, properly endorsed, with the Treasurer of the company to fulfill this agreement.

Until I further advise, would prefer that if you sell you do so only to or thru our brokers, Hammons & Company, 120 Broadway, New York City, (phone Rector 2-4400).

Cordially,

(S) R. H. Fleet.

RHF-B.

It is mutually agreed that the foregoing agreement is to terminate on December 31, 1941.

(S) R. H. Fleet.

(S) Charles A. Van Dusen.

Dated: San Diego, Cal., December 15, 1941.

On December 7, 1934, the common stock of Consolidated Aircraft Corporation sold on the New York Curb Exchange for a high of $9\frac{1}{2}$ and a low of $8\frac{7}{8}$. (R. 99.)

The price ranges of the common stock of Consolidated Aircraft Corporation sold on the New York Curb Exchange for the years 1932, 1933, and 1934 were as follows (R. 99):

Year	High	Low
1932	4¾	1
1933	12	1
1934	12⅞	6⅜

The common stock of Consolidated Aircraft Corporation had a par value of $1 per share, and a book value of $3.55 per share at December 7, 1934. (R. 99.)

There were 574,400 shares of the common stock of Consolidated outstanding on December 7, 1934, and R. H. Fleet owned 261,481 shares of the common stock on that date. (R. 99.)

The total number of shares of common and preferred stock outstanding on January 1, 1938, and December 31, 1938, December 1, 1939, December 1, 1940, and December 31, 1941, and the highest number of shares owned by R. H. Fleet during the years 1938, 1939, 1940 and 1941, were as follows (R. 99):

Capital stock outstanding—	Shares preferred	Shares common
Jan. 1, 1938	23,708	574,760
Dec. 31, 1938	23,820	574,760
Dec. 31, 1939	23,820	576,160
Dec. 31, 1940	23,820	578,605
Dec. 31, 1941	None	1,284,244

During the year 1941, 514 shares of preferred stock were retired at $55 per share and 23,306 shares were

converted into common at rate of two shares common for each share of preferred. (R. 100.)

The stock owned by R. H. Fleet was as follows (R. 100):

Year	Preferred	Common
1938	6,000	164,841
1939	6,010	164,241
1940	6,010	162,791
1941	6,010	348,822

The taxpayer purchased common stock of Consolidated from R. H. Fleet, under the terms of the agreement set forth above, as follows (R. 100):

Year	Shares	Market value when purchased	Cost
1938	600	$10,653.75	$3,000.00
1939	750	14,484.38	3,750.00
1940	400	9,875.00	2,000.00
1941	600	18,000.00	3,000.00

At all times from December 7, 1934, to December 31, 1941, the taxpayer was an employee of Consolidated Aircraft Corporation. (R. 100.)

R. H. Fleet claimed no deductions from gross income in his returns for the calendar years 1938, 1939, 1940 and 1941 for the difference between the fair market value of the common stock of Consolidated and the sale price of the common stock to taxpayer, but reported as income in his returns for those years the difference between the basis of the stock to him and the sum of $5 per share received on the sales to taxpayer. (R. 100–101.)

770785—47——2

Consolidated Aircraft Corporation claimed on its returns as deductions from gross income for the years 1938, 1939, 1940 and 1941 only the salary paid by it to the taxpayer for those years and did not claim any deduction with regard to the sales of its stock by R. H. Fleet to the taxpayer during those years. (R. 101.)

The Tax Court concluded (R. 101) that the option was given to taxpayer by Fleet as an inducement to secure his services for Consolidated. The termination clause was inserted because a termination of employment would terminate taxpayer's usefulness to Consolidated and to Fleet. The difference between the amount paid for the stock and its fair market value at the several dates of purchase was in the nature of compensation for services rendered or to be rendered by taxpayer.

SUMMARY OF ARGUMENT

A bargain purchase of corporate stock, the opportunity to make which is compensatory in character, results in income to the person to whom the privilege is afforded. It is not necessary, under the statute, that there shall be a technical employer-employee relationship between the grantor and the grantee; it is enough if the fact-trier finds that the grant was intended as remuneration for services. And that was the finding below in the case now at bar.

There is no merit to the taxpayer's alternative plea that if *arguendo* he received income here, he did so in the year the option was granted, and not in the years it was exercised as the Tax Court found. The

option was so conditioned that it could have had no value in itself as of the time of the grant.

ARGUMENT

The taxpayer realized income from his bargain purchases of the corporation's stock at the several purchase dates

a. It is immaterial that there was no employer-employee relationship between taxpayer and the grantor of the option to buy

Section 22 (a) of the Internal Revenue Code, *supra,* is broad enough to include in taxable income any economic or financial benefits conferred as compensation, whatever the form or mode by which it is effected. *Commissioner* v. *Smith,* 324 U. S. 177; *Old Colony Tr. Co.* v. *Commissioner,* 279 U. S. 716. And the concomitant Regulations, *supra,* specifically include in income property "transferred * * * by an employer to an employee, for an amount substantially less than its fair market value, * * *" even though the transfer takes the form of a sale or exchange, to the extent that the employee receives compensation. Thus a compensatory bargain purchase of corporate stock results in income to the person to whom the opportunity to make the purchase is afforded. See *Ward* v. *Commissioner,* 159 F. 2d 502 (C. C. A. 2d); *Hackett* v. *Commissioner,* 159 F. 2d 121 (C. C. A. 1st); *Frazer* v. *Commissioner,* 157 F. 2d 282 (C. C. A. 6th); *Oberwinder* v. *Commissioner,* 147 F. 2d 255 (C. C. A. 8th).

These general principles are conceded by the taxpayer at bar, but he claims (Br. 9 *et seq.*) that his particular situation is not encompassed by them. Specifically, he denies that the oportunity given him to

purchase the shares in question was compensatory in character—and this for the reason that the stock was the property of Fleet, the corporation's president, between whom and the taxpayer there existed no contract of employment. It is asserted (Br. 9) that taxpayer was the employee of the corporation which issued the shares, and not of the grantor of the option to purchase, whose personal holdings they were. The Government maintains, however, that the attempted distinction will not anywise serve to remove the taxpayer's case from the purview of the statute. It is, in our view, a distinction in effect without difference.

It is true that in the ordinary compensatory bargain purchase case, there *is* a technical contract of employment between the parties. And, parenthetically, we think it would be possible to argue here that this option was in fact the grant of the employer corporation, with Fleet merely the ostensible grantor. Cf. *Sweeney's Estate* v. *Commissioner,* 152 F. 2d 102 (C. C. A. 2d). Certainly there is nothing in the law of contracts to prevent a third party from furnishing the requisite *quid pro quo* for an agreement's validity. See Restatement of the Law of Contracts, Section 75. But if it be thought that such an argument is too speculatory of basis under the findings in this case, our answer is that there is really no necessity to indulge it. For Section 22 (a) does not speak of employment by contract, either formal or informal; it does not speak of contract at all. It states, as expansively as words make possible, that gross income shall include *inter alia* "compensation for personal service * * * of whatever kind and in whatever form

paid, * * *." It would seem, accordingly, that the taxpayer's argument reads into the statute a requirement not there; it is no *sine qua non* of inclusion that the compensatory bargain purchase shall be incident to an employer-employee relationship between the grantor and the grantee. All that is necessary, we submit, is that the opportunity shall have been intended as remuneration for personal services performed or to be performed by the grantee. *Bogardus* v. *Commissioner,* 302 U. S. 34.

In that light, this case is no different in principle from the *Smith* case, *supra.*[3] For assuredly, Fleet here intended, in giving this opportunity to purchase a part of his stock, to reward the taxpayer, so to speak, for the latter's continued efforts in his position as the corporation's factory manager. Fleet said so himself. Thus, his testimony ran (R. 103):

> Q. Do you recall the salary that was to be paid [to taxpayer by the corporation]?
>
> A. * * * I think it was $10,000.00 a year and he to take down 50 shares of my stock a month for $5.00 a share for the next ten years, or for ten years immediately following, conditioned upon his remaining in the employ of Consolidated Aircraft Corporation. * * *
>
> * * * * *
>
> Q. You also felt, did you not, Mr. Fleet, that the option which you gave Mr. Van Dusen would be regarded as something of an additional inducement to enter the employ of Consolidated?

---

[3] A point of difference, not now relevant, will be considered hereinafter.

A. I think so.

* * * * *

Q. But the motivating influence on your part of giving this privilege was to have Mr. Van Dusen work for Consolidated, wasn't it?

A. That's right.

Although such was manifestly not the case here as we shall presently see, we do not believe that, on strict legal theory, it would be necessary that Fleet should himself have been benefited, even indirectly, by taxpayer's continuing in the company service—the contemplated result of the grant to him of this opportunity to make bargain purchases of its stock. The benefit could go directly and exclusively to the corporation, with Fleet merely a third-party provider of the consideration, so long only as the grant of the privilege was not in fact the bestowal of a gift. Restatement of the Law of Contracts, *supra.* There was certainly no proof whatever of intended gift here. And the court below specifically determined (R. 101) that the option was granted to taxpayer as an inducement to secure his services for the corporation—a finding in itself negativing the idea of donative motivation on the part of the grantor, even without the further express declaration by the Tax Court in its opinion (R. 105) that "the benefit was not a gift by Fleet."

In our view these Tax Court determinations serve fully to distinguish the instant case from that of *Bogardus* v. *Commissioner,* 302 U. S. 34, upon which the taxpayer is here placing reliance. (Br. 10.) In *Bogardus,* the Supreme Court held that a payment

of money by a holding company to a former employee of an operating company was a gift rather than additional compensation. The parties had there stipulated, however, that the payment was not made for any services, past or future; on this and other facts the Court concluded that the payment was intended as a gift—that it was in fact an act of "spontaneous generosity" (p. 42). The *Bogardus* case might be termed the landmark decision on the principle that intention is the controlling factor in determining whether or not an item is compensatory in character; but it does *not* stand for the proposition that compensation can only emanate from one who is an employer. Quite to the contrary—for in the *Bogardus* situation as in this, the payment came from one who was technically a "stranger" to the contract of employment. Yet the Court indicated there that the result might well be otherwise where the evidence does not clearly show, as it *did* in *Bogardus,* that the payor's sole incentive was "the satisfaction which flows from the performance of a generous act" (p. 41). And as we have previously noted, far from concluding here that the grantor of this option was motivated by sheer altruism, the Tax Court took occasion specifically to point out (R. 104) that as president of Consolidated and a large holder of its stock, Fleet was personally and financially interested in the success and growth of the company, and therefore in securing the continued efforts of taxpayer toward those ends. The privilege was, moreover, expressly conditioned: It was to endure only so long as taxpayer remained in the company employ and

rendered his services to it. (R. 104.) In other words, Fleet was not parting with his stock to the taxpayer at such favorable prices unless he obtained from him "value received."

All of these matters, as well as the language used in the letter of grant (R. 97–98), point away from the notion of gift and lend more ample support, we think, to the Tax Court's conclusion that the opportunity which Fleet afforded the taxpayer to make these bargain purchases was intended to be compensation. Cf. *Poorman* v. *Commissioner,* 131 F. 2d 946 (C. C. A. 9th). And since intention is ultimately a factual question, on such substantiation the Tax Court's decision should certainly stand. *Commissioner* v. *Smith, supra; Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231.[4]

Furthermore, there is additional "evidence" that the *Bogardus* decision is not authority anywise *contra* to our position here, and that that position is sound. We refer now to the history of *Batterman* v. *Commissioner,* decided by the Tax Court February 5, 1943, on facts closely paralleling those which presently confront us. See 1943 P–H T. C. Memorandum Deci-

[4] We are of course aware (cf. Br. 10) that in the *Bogardus* case, the Court stated (pp. 38–39) that the question of whether an item is compensatory in character is a "mixed" one of law and fact, and therefore subject to review. We suggest, however, that in respect of that statement *Bogardus* is now "outmoded" by the *Dobson* decision and the numerous Supreme Court cases in accord. E. g., *Commissioner* v. *Tower*, 327 U. S. 280; *John Kelley Co.* v. *Commissioner*, 326 U. S. 521; *Commissioner* v. *Court Holding Co.*, 324 U. S. 331; *Commissioner* v. *Scottish American Co.*, 323 U. S. 119. The *Smith* case itself is evidence, we think, that *Bogardus* is obsolete on this point.

sions, par. 43,098. In that case as in this, the item the character of which was in issue emanated from one who was not the recipient taxpayer's employer; in that case as in this, the grantor was "selfishly" motivated. And there, just as here, the Tax Court held the transfer to constitute the payment of compensation—despite the same plea which the instant taxpayer makes: That there can be no "compensation" in the absence of an employer-employee relationship between grantor and grantee. The Tax Court's *Batterman* opinion stated:

> We know of nothing to prevent another than the employer from paying compensation for the employee's services, where, as here, he has a real interest in the services to be performed. Whether a limited and temporary employer-employee relationship sprang up between Dr. Dohme [the grantor] and the petitioner, or whether the transaction was, in effect, a contribution by the former to the capital of the corporation to enable it to pay the additional compensation to petitioner, need not be decided.

And of the *Bogardus* decision, upon which the *Batterman* taxpayer relied as supporting his position, the Tax Court said:

> * * * [That] case turned on the Court's conviction that the payment was intended as a gift.

The *Batterman* case was taken to the Circuit Court of Appeals for the Sixth Circuit, and there it was *per curiam* affirmed, 142 F. 2d 448. But more importantly for the purpose of the point we now are making, the

Supreme Court denied certiorari (322 U. S. 756), although the chief basis of the taxpayer's petition to that Court was the *Bogardus* case. Incidentally, this denial of certiorari post-dated the *Dobson* decision—a strengthening point at least by inference, we submit, in support of our suggestion (footnote 4) that insofar as the *Bogardus* case held the matter of intention in these situations to be a reviewable one as a "mixed" question of law and fact, the decision is no longer good law.

Another case involving a nonemployer payor is *Schumacher* v. *United States,* 55 F. 2d 1007 (C. Cls.). There a bonus paid to the president of a railroad company by the holding corporation which owned the railroad's stock was held to be compensation. The court there said in rejection of the claimant's theory of gift (p. 1011):

> It is immaterial that the payment received by the plaintiff was made by the holding company rather than by the company for which he had rendered service. The entire capital stock of the railroad company was owned by the holding company. The economic interests of the two companies were identical. The purchase price received from the sale of the railroad company went to the holding company. That the money received by the plantiff was not paid directly by the railroad company but * * * by * * * the holding company does not change the essential character of the transaction, and make a gift out of what was intended to be, and in fact was, additional compensation for services rendered.

A situation similar to the *Schumacher* case was presented in *Bass* v. *Hawley,* 62 F. 2d 721 (C. C. A. 5th), and the same result was there reached. In that case too it was urged that not the payor, but another, was the employer of the taxpayer recipient. To that argument, however, the court simply answered (p. 724) that where intent is the question, the substance of the matter must be looked to rather than the form, and that the want of a technical employment relationship between payor and payee did not require a finding that the payment was a gift.

b. The compensation was received as of the times when the option was exercised, and not as of the time it was granted

Taxpayer argues in the alternative (Br. 12 *et seq.*), that assuming *arguendo* the receipt of compensation here, it was received as of the time the option was granted and not, as the Tax Court found (R. 101), at the several purchase dates. We think it plain that this argument has no more merit than does the taxpayer's principal one.[5]

Taxpayer's thesis runs thus: In *Commissioner* v. *Smith, supra,* the Tax Court has found that at the date of the option the market value of the stock did not exceed the option price; in this case, however, the court below has determined (R. 99) that on December 7, 1934, the date of the oral option (R. 97), there was a differential of between 3⅞ and 4½ between option and market price. That differential, it is urged, gave to the option itself a present value at the date of the

[5] This alternative theory was apparently not advanced in the Tax Court. Indeed it would appear to be inconsistent with the allegations in paragraph 5 (f) of the taxpayer's petition. (R. 7.)

grant and therefore marked the time when the compensation was received. But in our opinion the conclusion by no means follows from the premise; in addition, there are several obstacles to the taxpayer's making any argument at all here that the option itself was the "compensation" received. In the first place, not only is there no finding by the Tax Court that the option had a present value on the date it was given, but also there is not even a finding that the option as such was *intended* to be compensatory of the services which taxpayer was to render. Moreover, there is a total failure on the part of the taxpayer to produce evidence which would warrant such findings. Certainly, as we intend fully to demonstrate hereinafter, he does not do so merely by showing a price differential on the date of the option.

The findings actually made by the Tax Court, and which we have shown are adequately supported by the record, are even more explicit than the findings in *Commissioner* v. *Smith, supra,* upon which the Supreme Court affirmed the Tax Court's decision in that case. Here the Tax Court has expressly found (R. 101) that—

> the difference between the amount paid for the stock and its fair market value at the several dates of purchase was in the nature of compensation for services rendered or to be rendered.

In the presence of this statement, and in the absence of any finding that the option had a market value when given, there seems to us no room for argument

that the option could itself operate to compensate the taxpayer.

Moreover, we submit, the record affirmatively compels the conclusion that the option had no market value when given. As we have stated, the taxpayer appears to believe (Br. 12) that he has proved to the contrary by showing that on the day the oral option was granted, Consolidated stock sold for an amount in excess of the option price. We do not believe, however, that in the circumstances of this case, that fact provides anything of the kind. The Supreme Court said in *Commissioner* v. *Smith, supra* (p. 181), that when the option price is less than the market price of the property for the purchase of which the option is given, it may have present value and may be found to be itself compensation for services rendered. But the Court went on there to say (p. 181) that the option could only so operate as it might be the means of securing the transfer of the shares of stock from the employer to the employee at a price less than their market value,—

> or possibly, which we do not decide, as the option might be sold when that disparity in value existed.

Manifestly, neither one of these conditions is fulfilled here. Preliminarily, it may be noted that, while the oral option was given on December 7, the option could be exercised only while the taxpayer was in the company's employ, and such employment did not begin until December 10, 1934. (R. 96, 97–98.) Hence the fact of a differential between option and market price

on December 7 would seem somewhat academic; and the record fails to show what the market price of Consolidated stock was on December 10, 1934, which was the earliest date on which any shares might have been acquired under the option.

Moreover, this grant could not, under its terms, operate to secure the transfer to the taxpayer of any more than fifty shares of the stock in December of 1934, when the option was given, or in any one month thereafter. (R. 97–98.) So there would certainly be no basis whatever for setting as the minuend figure for the worth of this option in respect of the 2,350 shares which were actually acquired under it between 1938 and 1941 (R. 100), the value of that number of shares on the option date. The stock rose appreciably in value after that time; for example, when taxpayer made his 1938 purchases, it was worth close to $11 per share as against the December 7, 1934, high of 9½. (R. 99, 100.) At the 1941 purchase date, its value was $30 per share. (R. 100.) And this is to assume now, referring again to the terms of the grant (R. 97–98), that the taxpayer would have been able to command the transfer of *any* shares under the option; he could not have done so, of course, unless he had remained in the company employ, and that was a matter which could not be known at the date which taxpayer is now urging as being the critical one.[6]

[6] It is to be noticed, too, that the option was to endure for ten years from its date, unless Fleet, the grantor, were to die or himself to quit the company employ—in which event the time was shortened to five years from date. (R. 98.) Had this contingency happened, there could have been no purchases made after December of 1939.

This brings us, we think, to the second of the Supreme Court's points in the *Smith* case with respect to the situations in which an option may itself operate as compensation, i. e. (p. 181)—"as the option might be sold when that disparity in value [the disparity between market value and option price] existed." And we ask ourselves accordingly: Could this option have been sold on the option date for the difference between the then market value of the shares and the option price? Could it have been sold, indeed, at *any* price other than purely nominal? The answer, we think, is decidedly in the negative.

It was decided in *Ward* v. *Commissioner,* 159 F. 2d 502 (C. C. A. 2d), that for income tax purposes, the value to an employee of what is received as compensation for services is in final analysis its "disposal" value. So here: To what purchaser could the taxpayer have "disposed" of an option which was expressly conditioned on so uncertain a factor as his continuance in the employ of the issuing corporation. Obviously, he might have quit or been discharged for any number of reasons—or for no reason at all—and the buyer would have been quite helpless.[7] The factual situation here is indeed somewhat similar to that which existed in the *Smith* case itself. There the taxpayer's acquisition of the stock which was the subject matter of the option was dependent

[7] Unless of course as part of the sale of the option rights, the taxpayer had promised the purchaser to remain. But even that would not have protected against the taxpayer's discharge, or the possibility that the company itself might go out of business.

upon his grantor's own acquisition of the stock, which in turn was dependent upon the grantor's performance of a certain contract with the issuing corporation. *Commissioner* v. *Smith,* 324 U. S. 177, 178–179. The contingency in the *Smith* case was perhaps of a greater degree of complexity than the one in our case, but the effect, we think, is precisely the same. The condition renders the option incapable of anything except "hindsight" evaluation.

Furthermore, as we have previously indicated, the privilege of this taxpayer to buy was limited to fifty shares per month over a ten-year period; it is therefore quite obvious that any prospective purchaser of this option would be buying the chance that the value of the stock might fall during the potential purchase period, even below the option price. The effect of this hazard alone upon the amount anyone would be willing to pay for the option would be such, in our judgment, as to make its "disposal" value negligible on the date it was granted.

We think that the rule of the *Smith* case clearly governs the disposition of this one, and that the Tax Court was eminently correct in holding (R. 101) that the compensation received by taxpayer was the difference between the amount paid for the stock and its fair market value at the several dates of purchase.

CONCLUSION

The judgment of the Tax Court should be affirmed.

Respectfully submitted.

THERON LAMAR CAUDLE,
Assistant Attorney General.
GEORGE A. STINSON,
LEE A. JACKSON,
MARYHELEN WIGLE,
Special Assistants to the Attorney General.

DECEMBER 1947.

U. S. GOVERNMENT PRINTING OFFICE: 1947